access to unbundled facilities should exceed incremental cost, and should be high enough to serve as a screen against the entry of inefficient firms, but should be low enough to enable efficient firms to enter the downstream market and compete in a way that can actually make consumers better off from enhanced competition on the merits.

Once the important role of the price of access to unbundled facilities is realized, it is clear that the simple incremental cost-pricing of such access is a ludicrous pricing proposal. It wrongly assumes that the LECs should price access to unbundled facilities so that the incremental profits from doing so are zero! And it wrongly assumes that entrants (even efficient ones, those that can make consumers better off in related retail markets) will always need the unbundled facilities at incremental cost prices or they will not be able to enter the market. It is an incorrect, one-sided view of access pricing that considers only the needs of the entrants, but fails to see the "big picture," which also includes the incumbent firms and consumers. The economics and regulatory literature is clear on the issue of the pricing of inputs (such as unbundled loops, in the MFS proposal): efficient prices of unbundled inputs such as loops should exceed incremental cost by a potentially wide margin.[37] For MFS to propose otherwise

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[37] Socially optimal interconnection rates are those rates which maximize the change in economic welfare between the pre-entry period and the post-entry period. Thus, socially optimal interconnection rates are designed to maximize the algebraic sum of incumbent firm profits, entrants' profits, and consumer surplus in the downstream retail market. For a survey of methods used to arrive at interconnection rates, see Alexander C. Larson, Pricing Principles in Telecommunications, in Telecommunications Law, (continued...)

is ludicrous, self-serving and potentially detrimental to consumers.

2. Competition v. Entry

Not all entry into telecommunications markets constitutes efficient, welfare-enhancing competition that the antitrust laws or sound regulatory policy were designed to protect or promote. The FCC should only be concerned with efficient competition, not mere entry. MFS proposes the fostering of entry, which it wrongly equates with efficient competition. Unfortunately for MFS, there is a very big difference between the two concepts, and mere entry of firms into the local exchange market via unbundling of loops may not constitute the type of competition that can make consumers better off. This is especially true if such entry must be attained by wrongly offering unbundled loops to firms such as MFS at a cap of total service long run incremental cost (TSLRIC) as recommended by MFS.

MFS has clearly mischaracterized what true competition is all about. For example, MFS argues that "[t]he refusal to unbundle the loop from the other elements of local exchange services . . . in the vast majority of states precludes potential competitors such as MFS from combining the LEC's loop with their own switching port

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[37](...continued)
Regulation, and Policy (William H. Read & Walt Sapronov, eds., forthcoming); William J. Baumol & Sidak, Toward Competition in Local Telephony (1994) [hereinafter cited as Baumol & Sidak, Competition]; William J. Baumol & J. Greogry Sidak, The Pricing of Inputs Sold to Competitors, 11 Yale J. on Reg. 171 (1994); William B. Tye, Pricing Market Access for Regulated Firms, 29 Logistics & Transp. Rev. 39 (1993); Jean-Jacques Laffont & Jean Tirole, A Theory of Incentives in Procurement and Regulation 255-258 (1993) [hereinafter cited as Laffont & Tirole, Incentives].

to furnish local exchange service and thus deprives business and residential customers of the economic benefits of price competition, enhanced service offerings and enhanced customer service in the local exchange market."[38] However, a "competitive environment" does not involve inefficient tariff rates that entering firms can selectively undercut without having to worry about the legitimate pricing responses of the incumbent firms; nor does it involve the selective mandated access to an incumbent firm's facilities when entrants are not efficient in all areas of producing a service.

3. MFS Assumes That Unbundling Without Price Reform In Telecommunications Markets Is In The Public Interest.

MFS advocates loop unbundling, but fails to point out that any type of unbundling is nonsensical if prices are not adjusted or rebalanced to correct for inefficiencies which have been the result of years of regulation. These inefficient prices may create unwarranted competitive advantages for firms such as MFS if unbundling were to proceed without pricing reform.

Before any type of mandatory unbundling is pursued, it is imperative that prices in telecommunications markets be made as efficient as possible. This will allow a more accurate assessment of the prospective benefits unbundling policies may actually be expected to yield. Thus, before any unbundling plan can even be considered, there should be a review of existing prices. If this were done, it would most likely require reform in LEC access service markets to allow market-based pricing of such services, and

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[38] MFS Petition at 17.

rate rebalancing in certain other markets to ensure cost recovery. Such rate rebalancing could entail: (1) a revision of the existing geographic averaging policy at the so-called "study area" level (which can be as large as several states) in favor of setting prices at geographic levels of aggregation that correspond more closely to true economic markets (such as the areas in which MFS wishes to enter); (2) adopting more economically sound depreciation schedules; and (3) allowing greater pricing flexibility on the part of the incumbent LEC in downstream, or retail markets.

Generally speaking, inefficient pricing has taken place in telecommunications in three ways. First, long distance services and access services have been priced to support aggregately priced basic local exchange services, particularly low priced flat rate residential basic local exchange service. This inefficient pricing was implemented to help meet the universal service goal of the Communications Act of 1934, a goal that largely has been achieved. Various federal and state government programs have been implemented to assist targeted low-income customers with their telephone bills. With respect to unbundling, prices should be restructured before entrants, which may be attracted to the access service market by inefficient prices, make sizeable inefficient investments. Once rates have been restructured, the true value of having mandated access to various network services via unbundling can better be assessed.

A second source of inefficiency results from the policy of geographic averaging of telephone service rates, including access charges. Geographic averaging requires that tariff rates

remain uniform over a geographic unit (a "study area") that may actually contain heterogenous markets. Thus, geographic averaging of carrier access charges most likely ignores differences in costs of serving customers that may exist within a given geography. For efficient pricing of carrier access services, geographic averaging must be jettisoned in preference of setting prices at geographic levels of aggregation that correspond more closely to true economic markets. If this is not done, geographically averaged prices will yield market niches beyond those which are already being exploited, where it may appear to be wise to unbundle, when in fact it is not. Unbundling to foster competition in downstream markets, when in fact both upstream and downstream prices are too high in various market segments, may merely foster inefficient investment by entrants.

A third source of inefficient pricing in telecommunications is the underdepreciation of plant. Telecommunications is subject to rapid changes in technology. As a result, the value of existing plant declines rapidly due to the acceleration in both technological and economic obsolescence of equipment. To the extent that prescribed historical depreciation lives and depreciation rates may have lagged behind changes in the telecommunications market, the resulting underdepreciation of LEC facilities has led to pricing distortions, since prices reflect continued depreciation of embedded plant that may no longer have any significant economic value. These pricing inefficiencies should be addressed prior to even considering any unbundling policies.

It is quite likely that a series of repricings (with some rates adjusted downward towards economic cost, and others adjusted upwards to ensure adequate cost recovery), without unbundling, will yield larger increases in consumer welfare than any which could result from MFS' economically inefficient "unbundling" proposal. Repricing services to better respond to market demand and competitive pressures would almost surely lead to increases in economic welfare that eclipse those obtained via MFS' proposed loop unbundling alone. If consumer welfare is increased by merely setting downstream prices at levels closer to economic cost, then rate rebalancing is a necessary prerequisite to any unbundling policy and may, in fact, eliminate the need for subsequent unbundling requirements. If rate rebalancing is not undertaken first, competitors may be enticed into market entry by inefficient prices, regardless of the likelihood of their success in an efficient market. Consequently, although unbundling may seem to be a good policy, large welfare gains are possible merely by the efficient pricing of existing bundled services. In effect, pricing inefficiencies create much of the demand for unbundling; if these inefficiencies are corrected, then there may no longer be a need for unbundling.

The importance of rate rebalancing as a necessary prerequisite to any unbundling policy cannot be overstated. An efficient "network of networks" cannot be built by inefficient providers who are in business primarily as a result of regulation-induced price advantages. SWBT's proposed rate rebalancing prerequisite is <u>not</u> a proposal that all inefficiencies be removed

from telecommunications pricing before unbundling policies are pursued. SWBT realizes that one cannot ask regulation to cure itself of its existing infirmities before allowing competition to emerge at the downstream stage, for in practice, things may tend to work the other way around -- the growth of competition forces regulatory agencies to gravitate toward more efficient pricing policies. There are, however, some rather obvious pricing distortions that should be remedied prior to even considering unbundling. If that were done, unbundling (if ultimately pursued) and resulting competitive market forces would foster greater efficiencies. On the other hand, the requests for unbundling from firms such as MFS may disappear if such pricing distortions were corrected.

4. "Unbundling" Is Not Required For Industry Cost Minimization

Loops should not be unbundled based on a claim that a firm requires access only to LEC loops to be in business. Substitute networks are rapidly being deployed in SWBT territories. For example, MCI Communications Corp. (MCI) is building a fiber-optic network that will circle St. Louis by the end of the year. The ring "will allow businesses to connect directly to MCI's network or give them an alternate path for data, voice or video communications. . . . The St. Louis ring is one of 10 being built this year. MCI has completed rings around Houston, Los Angeles and San Diego. MCI expects to build more rings in high-traffic areas

in the future."[39] In addition, MFS recently completed construction of an 80-route-mile fiber optic network connecting 42 buildings in St. Louis.[40] Therefore, it is highly questionable that any party will absolutely require access to an unbundled LEC loop. However, the fact that a prospective entrant or existing firm claims to need access to LEC network components such as unbundled loops to be in business does not make such components "essential," nor does it mean that mandating such access will further the competitive process in telecommunications.

Neither the courts nor regulatory agencies such as the FCC are expected to allow competitors to "cherry pick" all the most efficient assets of firms, and then use the regulatory process or wrongly-applied antitrust principles to somehow combine them to minimize industry costs in the markets in which they compete. If this were so, the courts would be involved in practically every American industry. Instead, the courts and regulatory agencies are charged with ensuring that the efficiency-enhancing competitive process takes place where, absent government intervention, it otherwise could not.

There is a very big difference between these latter two concepts. MFS seems to think that regulators must mandate access to the assets of integrated LECs so that they can be mixed with the assets of other, smaller or less integrated firms to provide telecommunications services at the least cost. Clearly,

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[39] As reported in the St. Louis Post-Dispatch, "MCI Builds Fiber-Optic Network Here," Wednesday, March 15, 1995, Business Section.

[40] Telecommunications Reports, March 27, 1995, p. 45.

competitive markets do not work this way, and the Commission need not support or mandate loop unbundling to foster true competition. In competitive markets, the most efficient combination of the assets of several firms results voluntarily through mergers and acquisitions, voluntary contracts, or other means, not by selective intervention by the courts or regulatory agencies.

To see this important distinction, consider the following illustrative example. Although there are a number of small micro breweries in the St. Louis area, Anheuser-Busch is by far the largest and most dominnant brewer in the area. There are probably many small brewers that could be in business and earn profits if Anheuser-Busch would simply share its facilities, distribution channels, or innovations with them. This clearly does not make such assets or innovations "essential facilities" required to make the brewing industry more competitive; and no government agency would mandate access to such assets or innovations. Such a policy would stifle the very innovations other firms would wish were shared with them.

However, suppose that Anheuser-Busch wished to pool its expertise and innovative methods with those of a smaller brewer to develop a new product and/or reduce the total costs of producing the product. In competitive markets, this function is served by mergers, partnerships, or other contractual arrangements. Government intervention (e.g., through unbundling of loops or other means) is not necessary to <u>force</u> this to take place.

B. The Status Quo Is Not Anticompetitive.

MFS argues that "[b]undling of the loop constitutes a tying arrangement because it forces buyers such as MFS to purchase unwanted products (the port and local usage) in order to obtain a wanted product (the loop)."[41] However, MFS has made several fundamental errors in characterizing the pricing of loops as an anticompetitive tying arrangement.

First, there are already available "loop" services where there is no tying to anything, other than the electronics necessary to make the "loop" function. Existing access services, e.g., Feature Group A, B & D entrance facilities, and a myriad of special access channel terminations, are ubiquitously available. What is it, other than an attempt to obtain a preferential price, that makes these existing services, with existing interconnection arrangements, unsatisfactory for MFS' use? If there are technical parameters or functionalities unavailable in these services, what are they? If the functionalities are not available in these access services, they will not be available in an unbundled "loop" of an existing bundled service.

Second, despite the Supreme Court's decision in Kodak, which MFS cites and on which it relies, the formal economics literature dismisses (and in fact, has always dismissed) tying arrangements as a means of leveraging market power into adjacent markets, a fact that has been noted by legal scholars for many years. For this reason, many courts have joined economists and noted legal scholars in concluding that tying arrangements in

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[41] MFS Petition at p. 18.

pricing should be presumptively lawful. Notably, MFS has not cited any of these courts, preferring to hang its hat largely on one case, Kodak.

Second, the market power assumption on which MFS has based its conclusion of loop pricing as comprising an anticompetitive tie-in is incorrect. MFS cites the Kodak court's definition of unlawful tying: a tying arrangement violates § 1 of the Sherman Act if (1) the seller has appreciable economic power in the tying product market, and (2) the arrangement affects a substantial volume of commerce in the tied market.[42] However, the assumption of "appreciable economic power" in the tying market does not hold for LECs' highly regulated switched access or basic local exchange services.

1. There Is A Paucity Of Support For "Leveraging" Theory In The Economics And Legal Literatures And The Courts.

Advocates of the theory of tie-ins, such as MFS, claim that tie-ins are a source of antitrust concern because they may foreclose other sellers of the tied good from an opportunity to compete on the independent merits of the tied good standing alone, without the influence of the tying good. However, leverage theory has never attained realistic credibility in the formal economics literature; at best, the literature supports its validity only under highly theoretical, but unrealistic circumstances, making leverage an extremely implausible scenario in real markets.[43] In

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[42] Id.

[43] See Alexander C. Larson, Antitrust Analysis After Kodak: A Comment, 63 Antitrust L.J. 239 (1994) for a survey of the economics literature on tying and leverage theory. Also see, Aaron Director

addition, adherence to the monopoly leveraging doctrine in the antitrust courts has been declining. As Judge Bork concluded in 1978: "The law's theory of tying arrangements is merely another example of the discredited transfer-of-power theory, and perhaps no other variety of that theory has been so thoroughly and repeatedly demolished in the legal and economic literature."[44] MFS' insistence that the LECs' failure to unbundle loops is a form of anticompetitive tying is the antitrust law version of using copper bracelets to cure arthritis: it is an old idea, and it has no support in the relevant literature. MFS is simply clinging to an idea that has been outmoded in legal and economic thinking for many years.

The courts have rejected the monopoly leveraging doctrine in numerous antitrust cases decided since 1991, making it difficult

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& Edward Levi, Law and the Future: Trade Regulation, 51 Nw. U. L. Rev. 281, 290, 292 (1956); Ward S. Bowman, Tying Arrangements and the Leverage Problem, 67 Yale. L. Rev. 19 (1957); M.L. Burstein, A Theory of Full-Line Forcing, 55 Nw. U.L. Rev. 62 (1960); M. L. Burstein, The Economics of Tie-In Sales, 42 Rev. Econ. & Stat. 68 (1960); Richard A. Posner & Frank H. Easterbrook, Antitrust: Cases, Economic Notes, and Other Materials 98-99 (1981); Roger D. Blair & David L. Kaserman, Vertical Integration, Tying, and Antitrust Policy, 68 Am. Econ. Rev. 397 (1978); Richard Schmalensee, Commodity Bundling by Single-Product Monopolies, 25 J. L. & Econ. 67 (1982); Roger D. Blair & David L. Kaserman, Antitrust Economics 382-394 (1985); Ward S. Bowman, Jr., Patent and Antitrust Law (1973); Richard A. Posner, Antitrust Law: An Economic Perspective 171-184 (1976); Robert H. Bork, The Antitrust Paradox 365-381 (1978); Note, An Analysis of Tying Arrangements: Invalidating the Leveraging Hypothesis, 61 Tex. L. Rev. 898 (1983); Keith K. Wollenberg, An Economic Analysis of Tie-In Sales: Re-Examining the Leverage Theory, 39 Stan. L. Rev. 737 (1987); José Carbajo, David de Meza & Daniel J. Seidmann, A Strategic Motivation for Commodity Bundling, 38 J. Ind. Econ. 283, 284 (1990); Michael D. Whinston, Tying, Foreclosure, and Exclusion, 80 Am. Econ. Rev. 837 (1990); and, Daniel J. Seidmann, Bundling as a Facilitating Device: A Reinterpretation of Leverage Theory, 58 Economica 491 (1991).

[44] Robert H. Bork, The Antitrust Paradox 372 (1978).

for plaintiffs in Section 2 cases to succeed today without showing that a defendant's conduct creates a dangerous threat of monopolization.[45] The courts today are concerned with economic efficiency and competition, not competitors. Even the Berkey court, which affirmed that the use of monopoly power in one market to gain a competitive advantage in another market is a violation of Section 2 of the Sherman Act (even if there has not been an attempt to monopolize the second market), recognized that denying integrated firms the benefits of integration could dampen their incentives to innovate.[46] Prior to 1991, the courts had rendered a small number of decisions based on the validity of the monopoly leveraging doctrine spawned by the Berkey court.[47] However, some courts questioned the wisdom of the doctrine from the beginning;[48] and starting in 1991, several courts either rejected the monopoly

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[45] See Joseph Kattan, The Decline of the Monopoly Leveraging Doctrine, 9 Antitrust 41 (Fall 1994).

[46] Berkey Photo, Inc. v. Eastman Kodak Co., 603 F.2d 263 (2d Cir. 1979), cert. denied, 444 U.S. 1093 (1980).

[47] Id. See Kerasotes Michigan Theatres v. National Amusements, Inc., 854 F.2d 135 (6th Cir. 1988), cert. dismissed, 490 U.S. 1087 (1989); Illinois ex rel. Hartigan v. Panhandle E. Pipe Line Co., 730 F. Supp. 826 (C.D. Ill. 1990), aff'd sum nom. Illinois ex rel. Burris v. Panhandle E. Pipe Line Co., 935 F.2d 1469 (7th Cir. 1991); and, Midwest Radio Co. v. Forum Publishing Co., 1990-1 Trade Cas. (CCH) ¶ 69,082 at 6,963-64 (D.N.D. 1989).

[48] Association for Intercollegiate Athletics for Women v. NCAA, 735 F.2d 577, 586 n.14 (D.C. Cir. 1984) (noting the "substantial academic criticism" of the doctrine, while finding it unnecessary to adopt or reject it); Consul v. Transco Energy Co., 805 F.2d 490, 494 (4th Cir. 1986), cert. denied, 481 U.S. 1050 (1987) (determining that there was no distinct monopoly leveraging theory under which a plaintiff could avoid the requirement of showing that the defendant threatened to monopolize a second market); Twin Laboratories, Inc. v. Weider Health & Fitness, 900 F.2d 566, 570 (2d Cir. 1990) (suggesting that the Berkey court's treatment of monopoly leveraging was mere "dictum.").

leveraging doctrine, or reinterpreted monopoly leveraging claims to allege a dangerous probability of monopolizing a market.[49]

Tying arrangements as a specific form of "leveraging" have also been discredited for many years in the legal and economic literatures. Before 1977, the courts considered tying to be a credible source of extending monopoly power, and dealt with it harshly, whereas the economics profession had for decades dismissed tying as a means of engaging in anticompetitive behavior.[50] Between 1977 and 1990, the economics literature persisted in its opinion on the efficacy of leveraging, but the courts took a softened view of tie-ins. After the Supreme Court's decisions in United States Steel Corp. v. Fortner Enterprises (Fortner II)[51] and Jefferson Parish Hospital District No. 2 v. Hyde,[52] plaintiffs were required

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[49] Alaska Airlines, Inc. v. United Airlines, Inc., 948 F.2d 536 (9th Cir. 1991), cert. denied, 112 S. Ct. 1603 (1992); Fineman v. Armstrong World Industries, Inc., 980 F.2d 171, 206 (3d Cir. 1992), cert. denied, 113 S. Ct. 1285 (1993); Spectrum Sports, Inc. v. McQuillan, 113 S. Ct. 884 (1993); Davis v. Southern Bell Telephone & Telegraph Co., 755 F. Supp. 1532 (S.D. Fla. 1994); Advanced Health Care Services v. Giles Memorial Hospital, 846 F. Supp. 488 (W.D. Va. 1994); Willman v. Heartland Hospital East, 1992-3 Trade Cas. ¶ 70,412 (W.D. Mo. 1993); Centennial School District v. Independence Blue Cross, 1994-1 Trade Cas. ¶ 70,526 (E.D. Pa. 1994); and, United States v. Eastman Kodak Co., 1994-1 Trade Cas. (CCH) ¶ 70,598 (W.D.N.Y. 1994). But see, Ortho Diagnostic Systems, Inc. v. Abbott Laboratories, Inc., 822 F. Supp. 145 (S.D.N.Y. 1993).

[50] See, e.g., Richard Schmalensee, Monopolistic Two-Part Pricing Arrangements, 12 Bell J. Econ. 445, 448 (1981)(analyzing tying contracts, and arguing that because tying contracts or equivalent pricing arrangements can increase aggregate welfare, "equity considerations do not provide much justification for antitrust hostility toward tying contracts.").

[51] 429 U.S. 610 (1977).

[52] 466 U.S. 2 (1984).

to demonstrate the defendant's possession of market power in the tying product, effectively legitimating most ties.[53]

In 1992, in Kodak, the Supreme Court relied on the issue of information failure, effectively ruling that imperfect information in a market can harm the efficient workings of an otherwise competitive market, and give even firms with small market shares the ability to harm consumers unfairly. It was the Kodak court's reliance on imperfect information that made its decision noteworthy from an antitrust perspective. This novel feature of the Kodak court's decision, however, has been condemned by economists, and has little to do either with telecommunications markets or with the validity of MFS' arguments. MFS has chosen to rely primarily on a convenient and controversial antitrust court decision as the basis of its argument for loop unbundling. This ignores the paucity of support either in the economic or legal literatures, or even the courts, for the efficacy of tying as an anticompetitive practice. Basically, MFS offers nothing more than "smoke and mirrors" as to just how a tying arrangement in pricing can somehow lead to anticompetitive practices.

Finally, the successful entry of new carriers into local exchange markets (or the ability of such firms to enter, even if they choose not to do so), further invalidates the credibility of the leverage theory.

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[53] See W. David Slawson, Excluding Competition without Monopoly Power: The Use of Tying Arrangements to Exploit Market Failure, 36 Antitrust Bull. 457, 459-473 (1991).

2. MFS' Conclusions On Tying Are Based On Faulty Assumptions.

MFS cites four criteria for a tying arrangement to exist: (1) the existence of two separate products; (2) an agreement conditioning purchase of one of the products (the "tying" product) upon purchase of the other product (the "tied" product); (3) the seller's possession of sufficient economic power in the tying product market to restrain competition in the tied product market; and (4) a not insubstantial effect upon interstate commerce.[54] However, even assuming arguendo that these criteria make economic sense, which they do not, MFS has still not made its case that a failure to unbundle loops is an anticompetitive tying arrangement.

a. The Existence Of Two Separate Products.

MFS argues that "the loop is plainly a product distinct from the switching port and local service," and claims that a functional linkage between two products does not make them a single product.[55] However, MFS has again neglected the effect that the price of access to an unbundled facility has in determining the efficacy of an unbundling proposal. MFS argues that loops, as separate from ports or local usage, are a distinct product in its eyes. Stripped to its essence, MFS' argument is: because MFS desires to have loops as separate products, then loops are separate products. However, MFS desires to have loops at a price capped at incremental cost. If the desire to have an unbundled facility such as a loop is conditioned primarily on a preferential rate

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[54] MFS Petition at p. 19.

[55] Id. at 20.

(incremental cost, in this case), then virtually any firm could argue for any type of unbundling. For example, if one firm (call it Firm X) can make and install motors more efficiently than General Motors (GM), it could use the MFS argument to make its case that GM provide it with an automobile with no motor, at a price of incremental cost or some similarly preferential rate; Firm X will then take the automobile (without motor), add its own motor, and sell it at a price lower than the GM price. It is clear that such an arrangement would do nothing to increase true competition for automobiles.

Further, MFS argues that "the question is not whether buyers might want to purchase one product without the other, but whether they 'may wish to purchase [the products] separately from different suppliers.'"[56] This has not been shown by MFS. If MFS' willingness to pay for unbundled loops is capped at incremental cost and a LEC reasonably would price loops above incremental costs, MFS' demand for such loops would presumably be zero.

b. An Agreement Conditioning Purchase Of One Of The Products (The "Tying" Product) Upon Purchase Of The Other Product (The "Tied" Product).

The simple bundling of goods or services is not equivalent to an agreement conditioning the purchase of one of the products upon purchase of the other product; nor is it a tie-in, anticompetitive or otherwise. Again, one could use the MFS logic, specious as it is, to argue that a personal computer (PC) maker engages in tying because it will not sell the separate components

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[56] Id., citing D.O. McComb & Sons, Inc. v. Memory Gardens Management Corp., 736 F.Supp. 952, 957 (N.D. Ind. 1990).

of its PC to any technically competent PC enthusiast who wishes to purchase them. MFS would also conclude that a cable TV company engages in anticompetitive ties because it will not sell separately the channels in its basic service package, yet it is more efficient to provide cable programming in this way. Clearly there are many such examples of why MFS has employed too stringent a definition of tying.

MFS has concluded erroneously that the bundling of services, or the lack of unbundling, automatically constitutes a tie-in. This is clearly not the case, and in fact, the economic efficiency aspects of any bundling strategy of marketing (or lack of unbundling) depend on many determinants that MFS has conveniently failed to discuss. The seminal papers in the economics literature indicate that whether bundling is beneficial or harmful to consumers depends on several variables, such as: (1) the distribution of customers' reservation prices (i.e., their maximum willingness-to-pay) for services; (2) the structure of production costs; (3) the structure of distribution costs; (4) the nature of competition in end-user markets; and (5) the way in which customers' reservation prices for separate services are correlated with each other (if at all).[57]

It simply is not possible to state unequivocally that a failure to unbundle separate "services" is a tie-in, and it is not possible to assess the economic efficiency of any bundling of services without examining determinants such as those listed above. MFS has failed to do this. Instead, it is merely relying on the

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[57] Larson, supra note 45 at 252.

blanket argument that any bundling of services (or any failure to sell the components of a service separately) is a tie-in that harms either competitors or consumers.

c. The Seller's Possession Of Sufficient Economic Power In The Tying Product Market To Restrain Competition In The Tied Product Market.

The market power assumption on which MFS has based its conclusion of loop pricing as comprising an anticompetitive tie-in is incorrect. MFS cites the Kodak court's definition of unlawful tying: a tying arrangement violates §1 of the Sherman Act if (1) the seller has appreciable economic power in the tying product market, and (2) the arrangement affects a substantial volume of commerce in the tied market.[58] MFS has correctly quoted the Kodak court. However, the assumption of "appreciable economic power" in the tying market does not hold for LECs' access services or its basic local exchange service (MFS does not make it clear to which tariff it objects).

Market power is the ability of a firm, or group of firms acting in concert, to increase prices above competitive levels for a significant period of time before either competitive entry or the actions of existing rivals require the increase in price to be rescinded.[59] It is easy to see why MFS' assumption that LECs have market power in the alleged "tying market" is incorrect. Both switched access and basic local exchange service are sold at prices that come under the stringent purview of various regulatory

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[58] MFS Petition at 18.

[59] William Landes & Richard Posner, Market Power in Antitrust Cases, 94 Harv. L. Rev. 937 (1981).

agencies such as the FCC or the various state PUCs. Note, however, that market power is the ability to control market output through price. Regulation makes this impossible. For a LEC to have market power for access services or local service, the appropriate regulatory agencies would have had to allow prices that are inefficiently high.

In addition, as explained supra, several alternatives to the LECs' offerings of access services, Centrex service, and business local service exist, and it is now possible for MFS and other firms to offer the alleged "tying" product.

IV. MFS' PROPOSAL IS NEITHER TECHNICALLY EFFICIENT NOR ECONOMICALLY REASONABLE.

MFS claims that loop unbundling will not require the significant development of new standards, hardware upgrades or software changes.[60] This claim is incorrect.

MFS' arguments are flawed with regard to the difference between local loops and the Access Tariffs. When a customer uses a LEC loop as part of a local switched service, the loop is typically a two-wire copper loop terminating on a LEC switch. The fact that the loop terminates on a LEC switch gives a LEC some capabilities that would not exist were the loop to terminate to a collocated carrier. From a LEC switch, the LEC is able to mechanically test local loops on a remote basis through the switch. This efficiency is not available if the loop does not terminate on a LEC switch.

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[60] MFS Petition at p. 35.

When the loop does not terminate on a LEC switch, and if the LEC wants to be able to assure its customers of the quality of the loop as well as be able to sectionalize trouble on the facility, the LEC must add an external test access point on the loop. However, this method requires the placement of individual test access points on each such local loop and access to a different type of remote test vehicle. This adds significant cost to the LEC's overall network. An alternative would be to allow connection to the local loop without the placement of a test access point. Although this would reduce the cost of the overall configuration, the LEC would then be unable to sectionalize troubles and advise customers quickly of the nature of any reported trouble. If trouble is reported, and without the placement of test access points, trouble isolation is problematic. In the event of a disagreement over the location of the trouble, repairmen must be dispatched and manual tests performed.

MFS is also in error with regard to the standards that would apply were the loop not to terminate on a LEC switch. The same two-wire loop that terminates on a local switch can also be used as part of a Special Access connection. In Special Access a customer can order a high capacity connection from a premise to a LEC central office where a multiplexer is ordered. This capability exists in the original Special Access tariff as well as on a Virtual Collocation basis. From the output of the multiplexer LECs already allows a customer to purchase an additive, two-wire local loop to a customer premises. The same two-wire loop that is used to provision local services is used in this two-wire extension of

a Special Access facility. MFS could order service on this basis and the end user customer could then disconnect its local exchange service.

In addition, since under MFS' proposal the connection no longer goes through a LEC switch, the LEC would have no way to determine the jurisdiction of the traffic that would be going over the unbundled loop. This is the reason Special Access connections are ordered as either 100% interstate or 100% intrastate.

MFS claims that the logical point of interconnection is the serving wire center.[61] While this statement is correct on one level, other factors must be considered when a loop is removed from a LEC switch. The logical interconnection point is the serving wire center. The logic of the wire center as the point of interconnection can be seen in the way service is offered in Access. Capabilities or service options offered by LECs are identified in the National Exchange Carrier Association Tariff F.C.C. No. 4. This is the vehicle where the LEC identifies the services it offers. This identification is accomplished on a wire center basis. While the majority of the functionalities identified in the tariff are switch-based, many of the functionalities are hardware capabilities as central office multiplexing. This is the multiplexing offered in a central office as described above.

MFS could order central office multiplexing on either a standard Special Access Tariff basis or on a Virtual Collocation basis. From the output of the multiplexer, MFS could then order a cross connect to a loop going to an end user premises. No delays

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[61] MFS Petition at p.36.

in service intervals would be encountered, as claimed by MFS, because the high speed, multiplexed facility would have been ordered ahead of the cross connect to the local loop. SWBT's interval for such cross connected services are among the lowest in the industry and rapidly moving toward delivery of service on a Customer Desired Due Date (CDDD) basis.

The fact that the wire center is the logical point of interconnection does not minimize the complexities and costs identified above. The process is not a simple matter of taking a customer's local loop and terminating it to a new provider. Functionalities, testing and costs must be taken into account.

MFS asserts that current expanded interconnection rules would apply to loop interconnection. MFS refers to double-ended pair gain, single-ended pair gain, and remote switch used for pair gain.[62] MFS merely attempts to "muddy the waters" by referring to some of the physical configurations used by LECs such as SWBT. To clarify, the double-ended pair gain is an internal carrier system placed in the loop plant, which allows SWBT to conserve copper. However, where and when SWBT uses such hardware is transparent to the end user customer and will be transparent to MFS as well. When a customer orders local, switched service, SWBT will use whatever facilities are available to furnish the service. The variety of facilities could include copper cable, subscriber carrier operating at the DS1 or 1.544 Mb/s rate, subscriber carrier operating at DS3, or 45 Mb/s, or SONET rings operating at digital bit speeds of 150 Mb/s and above. This does not change the service ordered by the

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[62] MFS Petition at pp. 38-42.

customer or alter the performance guarantees associated with the original locally switched service. Were MFS to request a high speed, special access connection to a SWBT wire center where multiplexing was offered and then order a single, two-wire extension to a customer premises, SWBT might employ any of the above-mentioned configurations and, again, none of the services or parameter guarantees offered would change.

In the case of the single-ended pair gain, SWBT employs carrier systems operating at 1.544 Mb/s interfacing directly into a digital central office. In such an instance, the digital central office is capable of accepting an interface at the 1.544 Mb/s rate without the need for an external, central office multiplex device. The switch itself can perform the multiplexing function internally. This arrangement allows SWBT to provide standard, locally switched service on a cost-reduced basis. This cost-reduced configuration and the double-ended pair gain arrangement are both factored into the overall cost of the local loop for all of SWBT's services and are included as part of the special access, two-wire voice extension from a central office multiplexer. SWBT could very likely be using the double-ended pair gain as part of the infrastructure to provide service. The integrated, or single-ended pair gain system would not be a consideration because of its very nature it would be integrated into the SWBT switch. Providing MFS access to customer loops that are currently provisioned on an integrated or single-ended pair gain basis forces SWBT to revert back to a double-ended and consequently more expensive arrangement to provide service. This contributes toward making the overall

network more expensive. If MFS is looking to provide service using its own switch, it would not need or want any part of a configuration that is integrated into a SWBT local switch. In the alternative, MFS could order the physical equivalent of the single-ended pair gain from a SWBT central office to a customer premises. This would require an FCC rule change to allow SWBT to sell a customer premises multiplexer at a specific price on a regulated basis rather than on a non-regulated basis.

The "remote switch used for pair" gain is an extension of a SWBT central office. Such devices are generally placed in small huts without much room for additional equipment. Because of the space restriction and the fact that we do not provide trunks from remote switches directly to other offices or carriers, SWBT does not offer a wide range of functionalities at remote switches. In this instance, MFS would see the remote as being transparent and order their connections from the central office. This would not restrict any of the connectivity being made available to MFS. Connection by MFS to customers served by a remote switch would cause SWBT additional capital expenditure. In order for SWBT to allow connection to customers served from a remote switch, SWBT would have to remove the customer from the remote switch and extend the loop facility back to the central office. This defeats remote switch configuration and forces significant capital expenditure on the part of SWBT.